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SUBJECT: BUSINESS PROCESS OUTSOURCING: A GROWTH OPPORTUNITY FOR SRI LANKA

1. Summary. As the business process outsourcing industry (BPO) continues to grow in South Asia, Sri Lanka is looking to expand its share of the market. However, attractive features such as low labor costs, low operating costs and government tax incentives are somewhat overshadowed by industry constraints, including inadequate education and IT infrastructure. The ongoing ethnic conflict also discourages new investors and BPO clients. Despite these challenges, there is room for growth and there are possible niches for Sri Lanka in providing disaster recovery centers and specialized, high-end services. End Summary.

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Growing BPO Presence in South Asia; Limited Sri Lanka Growth  
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2. The Business Process Outsourcing (BPO) industry continues to pour money into South Asia. Companies are looking for cheaper options for conducting basic business processes, and investors are taking advantage of labor market efficiencies in Asia to offer these services. The industry has grown to include many sophisticated and technical processes and has spread throughout South and East Asia.

3. Sri Lanka has seen some investment in the BPO sector, which currently employs just over 4,000 people. Sri Lanka is attractive to BPOs because of its low labor costs, low attrition rates, low operating costs, and significant government tax incentives. However, a number of factors are deterring greater investment in Sri Lanka including a relatively small labor pool, the ongoing ethnic conflict, a lack of necessary specialized skills, and IT constraints and costs. Addressing these problems will help Sri Lanka tap into a growing industry as the country tries to diversify and reduce its reliance on textiles.

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Basic to High-End Services: All Are in Sri Lanka  
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14. There are three main levels of BPO services offered in Sri Lanka, and U.S. companies are engaged in all three. The first level involves basic data entry services and document conversions, for example conversion of hard copy texts to e-books. The second level involves more sophisticated processes such as desktop publishing and basic accounting services. The third level includes high level services such as investment research, financial modeling, and quantitative analysis.

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Poor English Skills and Scarcity of University Graduates Constrain Growth  
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15. The growth of the BPO industry in Sri Lanka faces several constraints. BPOs tell us one major constraint is the lack of English language skills. Although Sri Lanka has a high rates of primary education enrollment and literacy, BPOs say it is difficult to find enough secondary school graduates with adequate English language skills. BPOs that provide low or mid-level services are willing to hire "A-level" (12 years of schooling) or "O-level" (10 years of schooling) high school graduates, but need them to have working level English. English was widely taught and spoken two generations ago, but for nearly 50 years most instruction has been in Sinhala or Tamil. English is being reintroduced in schools, but it will take many years to see significant improvement. U.S. BPO executives tell EconOffs that while companies provide internal training in "soft skills," such as communication skills, the applicant must possess basic English language skills to be hired. A

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2006 baseline sector analysis of the BPO industry commissioned by the Information and Communication Technology Agency (ICTA) of Sri Lanka indicates that 95 percent of BPOs consider the ability to communicate in English their most important skill requirement.

16. The dismal state of Sri Lanka's tertiary education system limits the skilled labor pool. Sri Lanka's university system is entirely state run and has not managed to keep up with the growing demands of Sri Lanka's student population or the business community. According to the Chairman of the University Grants Commission, only 15 percent of those who qualify for university entrance are actually admitted. Sri Lankan universities are not offering the subjects or the level of quality instruction necessary to meet business needs. In addition, there are few foreign schools present in Sri Lanka. Foreign schools are not allowed to confer Sri Lankan degrees, although they can offer foreign degrees. The ICTA study concludes that the quality and size of the Sri Lankan labor pool are inadequate to meet the competitiveness and growth needs of the BPO sector.

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IT and Transportation Capacities Limit Expansion  
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17. BPOs tell us Sri Lanka's information technology infrastructure is inadequate. BPOs are able to obtain dedicated lease lines for IT connectivity, but they say there is inadequate redundancy, or back-up capacity. In many cases, if an broadband line goes down, there is no way to continue to provide services to clients. There is also a lack of IT capacity outside of Colombo. BPOs we talked to said they would like to open offices in secondary cities like Kandy and Galle to take advantage of cheaper labor costs and untapped English language skills, but they cannot because of IT constraints. Executives also told EconOffs that IT costs in Sri Lanka are about 40 percent higher than in India. The ICTA study states that nearly half of BPOs surveyed listed telecommunications facilities as an infrastructure constraint and nearly 40 percent were dissatisfied with broadband facilities.

18. Road and mass transit systems also fail to meet BPO needs. Industry contacts tell us conducting business outside Colombo is

practically impossible because of the lack of good roads connecting secondary cities to the airport. They also say Colombo needs a reliable 24-hour mass transit system to make it easier for employees to get to work. BPOs often have employees working around the clock on 2 or 3 different shifts to provide real-time services to clients. City buses are overcrowded, do not run late at night, and are often unsafe for women traveling alone. To compensate, most BPOs offer transport to and from work for employees as well as meals, since restaurants are not open at night and employees can not travel home to eat. Nearly 60 percent of BPOs surveyed in the ICTA study considered mass transport service the leading infrastructure bottleneck to BPO operations and growth.

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Lack of Industry Awareness Discourages Applicants  
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¶9. Finally, BPO executives say there is a need to raise awareness of the BPO industry among the Sri Lankan public. BPO is a relatively new sector for the country, and increased awareness would result in a reduction in the stigma of working in the BPO sector and more applicants for BPO jobs. One executive told us that he knows of high school graduates with excellent language skills working in less technically-demanding jobs (the Pizza Hut counter was given as an example), because they do not know about the BPO industry and are reluctant to apply.

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Political Concerns Also Deter Investors  
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¶10. The ICTA study revealed that 67 percent of the BPO sector is concerned about domestic civil and political stability, in part because they fear that domestic strife could disrupt service delivery to clients. Our contacts at U.S. BPOs emphasized that one bomb at the Colombo airport or port could scare away BPO clients. One bomb could also destroy a company's telecommunications connectivity, making it impossible to deliver services.

¶11. U.S. BPO executives also say there is a need for legislation regarding working women. Technically, women in Sri Lanka are not allowed to work past 8 p.m., but the government has issued a waiver for the BPO sector. However, women remain reluctant to take BPO jobs because of the stigma associated with working late at night. Revising the laws might also help change public perceptions.

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Government Incentives Possibly Fading  
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¶12. One positive force for the BPO sector has been Sri Lanka's Board of Investment (BOI). The BOI provides investment incentives and expedited services to foreign investors. To date, the BPO sector has benefited from the BOI. However, the BOI is considering raising the standards for new businesses to qualify for BOI approval. Currently, there is no minimum capital investment requirement for BPOs or IT companies, only a requirement that those companies have at least 15 employees. The proposed regulations would require a mandatory initial capital investment of \$150,000 for all companies, including BPO and IT companies. U.S. BPOs point out correctly that many BPO and IT companies would not need to make an initial \$150,000 investment to set up business in Sri Lanka and the new regulation will effectively discourage new companies from coming here. The proposed regulation, aimed at keeping small beauty salons and restaurants from getting BOI incentives, may have the unexpected effect of discouraging two prominent industries from continuing to expand and invest in Sri Lanka's economy.

¶13. Comment: Despite these challenges, the Sri Lankan BPO sector provides attractive investment possibilities. The government and business community need to actively market the country as an advantageous site for back-up operations and disaster recovery centers. Sri Lanka's smaller size in comparison to India makes it ideal for these smaller scale operations. Sri Lanka can also create

a niche for itself by focusing on specialized, high-end services where volume and scale are less important. US companies have been successful in Sri Lanka and will continue to thrive as long as they keep implementing creative solutions to the country's capacity constraints.

BLAKE